No. 15112

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, a national banking association,

Defendant-Appellant,

vs.

UNITED STATES OF AMERICA,

Plaintiff-Appellee.

Appeal from the United States District Court for the Southern District of California, Central Division.

APPELLANT'S OPENING BRIEF

FILED

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No. 18142

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Bank of America National Trust and Savings Association, a national banking association,

Defendant-Appellant,

vs.

United States of America,

Plaintiff-Appellee.

APPELLANT'S OPENING BRIEF.

I.

JURISDICTIONAL STATEMENT.

The United States at the request of the Commissioner of Internal Revenue sued the Bank of America seeking a money judgment for $6,658.31 [R. 3-6, 25, 26]. The principal amount sued for is equal to the amount which stood, on the Bank's books, to the credit of one J. B. Edmondson in commercial and savings accounts at the time the District Director of Internal Revenue caused to be served upon the Bank a notice of levy in an attempt to collect delinquent taxes owed by Edmondson to the Government.

The jurisdiction of the United States Distirct Court was invoked pursuant to Title 28, Sections 1340 and

1345, and Title 26, Sections 7401 and 6332(b) of the United States Code.

Both plaintiff and defendant moved for summary judgment and the plaintiff's motion was granted. Within the time allowed by the law the Bank appealed [R. 32]. The jurisdiction of the United States Court of Appeals was invoked pursuant to the provisions of Section 1291, Title 28, United States Code.

II.

STATEMENT OF THE CASE.

In July, August and October, 1955, the Director of Internal Revenue made three assessments against the taxpayer, J. B. Edmondson, for delinquencies arising in 1955. Notice of one of these liens was filed in Orange County on October 19, 1955, and notices of the other two liens were filed in that County in January, 1958 [Finding 2(e), R. 26-27]. No demand for the payment of these taxes was ever made upon the defendant Bank prior to August 27, 1959, and the Bank had no knowledge prior to that date of the existence of any United States tax lien against property or rights to property of J. B. Edmondson [R. 19].

In March and September, 1958, and in March of 1959 Edmondson purchased automobiles on conditional sale contracts. The seller's interest in the contracts was assigned to the defendant Bank. At some time prior to August 27, 1959, Edmondson had borrowed money from the Bank on two separate loans. One of the loans was secured by a mortgage on a boat and

the other was evidenced by an unsecured promissory noted [Findings 2(i), (j) and (k), R. 28].

On August 27, 1959, there was a total balance due from Edmondson to the Bank on the conditional sale contracts of $9,161.26. On the same date there was due from Edmondson to the Bank the sum of $1,179.14 on the boat loan. On the unsecured note Edmondson owed $1,230.10, which balance was also due to the Bank on that date. The total indebtedness due from Edmondson to the Bank on August 27, 1959, was, therefore, $11,570.50 [Finding 2(1), R. 29].

Within the few weeks immediately preceding August 27, 1959, Edmondson deposited in various accounts which he maintained with the Bank certain checks [R. 22-23]. As a result of these deposits the Bank's books showed a credit on August 27, 1959, in accounts standing in the name of J. B. Edmondson of $6,658.31. [R. 27].

On August 27, 1959, the District Director of Internal Revenue served upon the Bank, for the first time, a notice of levy purporting to levy upon all property or rights to property belonging to the taxpayer, J. B. Edmondson. The notice demanded surrender by the defendant Bank of all property or rights to property, monies, credits and bank deposits then in its possession and "belonging to the taxpayer" and all sums or other obligations owing from the defendant Bank to the taxpayer. The Bank refused to honor this demand [R. 27-28]. The United States then sued.

Both the government and the Bank moved for summary judgment. The Trial Court granted the government's motion and indicated in his comments that banks should be under a duty to examine county lien records before making loans or accepting deposits from their customers [R. 30]. From this judgment the Bank appealed.

III.
SPECIFICATIONS OF ERRORS.

The Trial Court's judgment was contrary to law because:

1. United States tax liens attach only to property or rights to property of the taxpayer, and under federal law the existence and the extent of the "property and rights to property of the taxpayer" is determined by state law.

2. Under California law cross-demands "shall be deemed compensated," so that under the facts of this case there was no "property or rights to property" of the taxpayer in the possession of the Bank to which United States tax liens could attach.

IV.
SUMMARY OF ARGUMENT.

1. Whether a taxpayer has any rights to property to which a federal tax lien can attach is a question to be determined by applicable state law. The rights of the government rise no higher than the rights of the taxpayer against the Bank and are no broader in scope.

2. Under applicable California law cross-demands are deemed compensated so that under the facts of the instant case there was no property nor rights to property of the taxpayer in the possession of the Bank to which United States tax liens could attach.

(a) Since Edmonson owed the Bank $11,570.50 on the date of the levy and the Bank owed Edmondson at that time only $6,658.31, the net balance owing from Edmondson to the Bank on the date of the levy was $4,812.19. Under California law the Bank had the right to set off the balances owing by it to Edmonson against the balances owing by Edmondson to the Bank.

(b) The Bank's right of setoff was completely choate on the date of the levy since all that the Bank had to do in order to enforce its right of setoff was to refuse to pay money which it did not owe to Edmondson or to the government.

3. The government had no enforceable lien upon the checks deposited by the taxpayer or upon the proceeds collected by the Bank by the use of the checks.

4. The decision in *Bank of Nevada v. The United States* is distinguishable from the instant case and is inconsistent with later Supreme Court decisions.

V.

ARGUMENT.

1. Whether a Taxpayer Has Any "Rights to Property" to Which a Federal Tax Lien Can Attach Is a Question to Be Determined by Applicable State Law.

In *Aquilino v. United States,* 361 U. S. 501, 4 L. Ed. 2d 1365, 80 S. Ct. 1227 (1960) the Court said (L. Ed. p. 1368):

> "The threshold question in this case, as in all cases where the Federal Government asserts its tax lien, is whether and to what extent the taxpayer had 'property' or 'rights to property' to which the tax lien could attach. In answering that question, both federal and state courts must look to state law, for it has long been the rule that 'in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property . . . sought to be reached by the statute.' *Morgan v. Commissioner,* 309 U. S. 78, 82, 84 L. Ed. 585, 589, 60 S. Ct. 424. Thus, as we held only two terms ago, Section 3670 'creates no property rights but merely attaches consequences, federally defined, to rights created under state law . . .' *United States v. Bess,* 357 U. S. 51, 55, 2 L. ed. 2d 1135, 1140, 78 S. Ct. 1054."

In other words, it is only after a United States tax lien has attached to legally enforceable property interests of the taxpayer, as determined by the applicable state law, that we enter into the province of federal law to determine the priority and consequences of competing liens.

An excellent discussion of the principles applicable to the decision in the instant case is found in *United States v. Bess,* 357 U. S. 51, 2 L. Ed. 2d 1135, 78 S. Ct. 1054 (1958). There the Court was confronted with the question of the extent, if any, to which United States tax liens attached to the proceeds of life insurance policies payable to the wife of the taxpayer as beneficiary in the situation where the taxpayer had died after the lien was perfected. The Court held (1) that the United States tax liens attached only to "property and rights to property" of the taxpayer and (2) that the rights of the beneficiary under the policy were to be determined under state law. Applying these principles the Court said (L. Ed. p. 1140):

> "We must now decide whether Mr. Bess possessed in his lifetime, within the meaning of §3670, any 'property' or 'rights to property' in the insurance policies to which the perfected lien for the 1946 taxes might attach. Since §3670 creates no property rights but merely attaches consequences, federally defined, to rights created under state law, Fidelity & Deposit Co. v. New York City Housing Authority (CA2 NY) 241 F2d 142, 144, we must look first to Mr. Bess' right in the policies as defined by state law.
>
> "(a) It is not questioned that the rights of the insured are measured by the policy contract as enforced by New Jersey law. Manifestly the insured could not enjoy the possession of the proceeds in his lifetime. His right to change the beneficiary, even to designate his estate to receive the proceeds, gives him no right to receive the proceeds while he lives. Cf. Rowen v. Commis-

> sioner (CA2) 215 F2d 641, 644. It would be anomalous to view as 'property' subject to lien proceeds never within the insured's reach to enjoy, and which are reducible to possession by another only upon the insured's death when his right to change the beneficiary comes to an end. We therefore do not believe that Mr. Bess had 'property' or 'rights to property' in the proceeds, within the meaning of §3670, to which the federal tax lien might attach. Cannon v. Nicholas (CA10 Colo) 80 F2d 934; see United States v. Burgo (CA 3 NJ) 175 F2d 196. This conclusion is in harmony with the decision in Everett v. Judson, 228 US 474, 57 L ed 927, 33 S CT 568, 46 LRA NS 154, that the cash surrender value of a policy on the life of a bankrupt is the extent of the property which is vested in the trustee under §70a of the Bankruptcy Act."

Paraphrasing the language of the Supreme Court as applied to the instant case, it would be anomalous to view as property subject to lien, proceeds never within Edmonson's reach to enjoy, and which are reducible to possession only upon Edmondson's discharge of his accrued indebtedness to the Bank. In *Bess* the condition precedent to the taxpayer's right to compel the insurance company to pay the full face amount of the property was his death; in the instant case the condition precedent to Edmondson's right to compel the Bank to pay its debt to him was the discharge of his debt to the Bank. It seems obvious that if Mr. Bess had borrowed money from the insurance company against the cash surrender value of his policies, the government's lien rights against the cash surrender value

would be reduced by an amount equal to the amount the taxpayer had previously borrowed. So also in the instant case, having borrowed money from the Bank and become obligated to the Bank, it seems apparent that the government's lien in the instant case attaches only to a chose in action which is completely defeated by the existence of the Bank's counterclaim.

Many other illustrations of the applicability of these sound principles are available.

In *In re Halprin,* 280 F. 2d 407 (3d Cir. 1960), it appeared that after the filing of a United States tax lien against *Halprin* he borrowed money and assigned to the lender monies to become due him under an executory contract for the sale of merchandise. In ruling that there was no "property or rights to property" subject to the United States tax lien, the Court said (p. 410):

> "From a somewhat different approach, such a lender as Commercial has enriched the taxpayer's estate by the amount loaned to the taxpayer. For this reason, it is not unreasonable to allow it a corresponding security interest in the fruit of the borrowed money, with the government relegated to the borrowing taxpayer's net after the lender is reimbursed. The government has suffered no diminution of the assets which were available to satisfy its tax claim before the loan. In addition, if the tax collector should seize the borrowed funds before their expenditure he could do so.
>
> "For these reasons we conclude that Doniger's promise to pay for goods if and when delivered, as stated in an executory bilateral contract did not constitute 'property . . . belonging to' Halprin,

> subject to a tax lien under Section 6321. Later, when goods were manufactured and delivered to Doniger, his unqualified obligation to pay, as it then came into existence, ran solely to Commercial and thus could not be reached by any lien on Halprin's property."

In other words, neither Halprin, nor Edmondson in the instant case, ever had any right to receive the funds.

Applying the approach of the Court of Appeals for the Third Circuit to the instant situation, it becomes apparent that the Bank has actually enriched the taxpayer's estate by the amount of funds advanced to him. As the Court said in *Halprin, supra*;

> "For this reason it is not unreasonable to allow it a corresponding security interest in the fruit of the borrowed money, with the government relegated to the borrowing taxpayer's net after the lender is reimbursed."

Another way of expressing the thought that United States liens attach only to the property of the taxpayer is found in *United States v. Manufacturers Trust Co.*, 198 F. 2d 366 (2d Cir. 1952), where the Court ruled (p. 367):

> "The distraint, at most, gave the government the rights of a judgment creditor who has levied upon the depositor's property, *United States v. Warren R. Co.*, 2 Cir., 127 F. 2d 134, and, as such, the government obtained no greater rights than the depositor."

In *United States v. Metropolitan Life Insurance Co.*, 130 F. 2d 149 (2d Cir. 1942), the government sought to reach the cash surrender value of an insurance policy

on the life of the taxpayer. The Court in an opinion by Circuit Judge Learned Hand held that the taxpayer's claim was not property of the taxpayer in the possession of the insurance company which the insurance company "surrendered" by paying. Judge Hand said (p. 151):

> ". . . Certainly the section gives no evidence of any purpose to allow the United States to mend in the District Court all infirmities of title in the taxpayer's property. The diction, the setting and the purpose of the section unite to deny the plaintiff's interpretation of the word 'property.' "

So also in the instant case the government is not entitled to mend the "infirmity" in Edmondson's position which arises inevitably from the Bank's counterclaim.

In *United States v. The American National Bank of Jacksonville*, 255 F. 2d 504 (5th Cir. 1958), the Court held that where title to real property was held by the taxpayer and his wife as tenants by the entireties, the taxpayer had no property interest in the land to which the tax lien could attach and therefore a mortgage given to the Bank by the taxpayer and his wife after the tax lien was filed took precedence over the government's claim. The reasoning of the Court was that the individual interest of the husband or wife in an estate by the entireties was not such an estate as may be subjected to the grasp of an attaching creditor or which would permit the adherence of a tax lien. The Court, quoting from *United States v. Hutcherson*, 188 F. 2d 326, 331 (8th Cir. 1951), said that it was not at liberty to change the nature of the estate for the benefit of the government.

In *Wolverine v. Phillips,* 165 F. Supp. 335 (N. D. Iowa, 1958), the controversy was between the surety on a bond of a defaulting building contractor and the government as holder of tax liens against the contractor. It was held that where the contractor breached his contract with the owner before the balance of money became due so that the contractor had no enforceable right against the owner to recover the balance, the federal government was not entitled to the balance paid into escrow and such balance was payable to the surety. The Court said (p. 353):

> "Therefore in the present case in order for the government's tax liens to be of avail to it there must at some time have been created under state law some enforceable right in behalf of the contractor against the owner for money due under the contract. As heretofore noted at the time the tax liens arose, the contractor had already been paid the progress payments and the only money that could thereafter be due it would be the money due it upon the completion of the contract. Before that latter event occurred the contractor had committed a breach of contract, the damages for which amount to $19,248.02."

So also in the instant case the only money that the Bank could be compelled to pay to Mr. Edmundson would be money due him upon full payment of his obligations to the Bank which were due. Before payment by the Bank of the funds standing to Edmondson's credit in the bank account, Edmondson would, under the law, be required to discharge his obligations to the Bank.

The most recent well-considered discussion of this problem is found in *Chicago Federal S. & L. Assn. v.*

Cacciatore, decided by the Supreme Court of Illinois September 28, 1962, Docket No. 37093 (62-2 USTC, p. 85999, par. 9739). In that case the Court held that even though the federal tax lien had been filed prior to the recording of a second deed of trust, the government had no interest in the real estate held in trust for the benefit of the taxpayer. The government contended that since the taxpayer at the time of the lien was in a position and had a legal right to withdraw the real estate from the trust and receive the property back subject only to the first trust deed, the government had the same right. The Court pointed out that the government did not bring a creditor's bill or take other action seeking assertion of this right at any time prior to the recording of the second deed of trust, and since it did not do so it was junior to the second deed of trust.

The Supreme Court of Illinois relied heavily upon *United States v. Brosnan,* 363 U. S. 237, 4 L. ed. 2d 1192, 80 S. Ct. 1108 (1960), where the Supreme Court held that a government tax lien was wiped out by a foreclosure under a power of sale in accordance with California law, stating that long accepted non-judicial means of enforcing private liens as established by state law constitute an acceptable method of wiping out or nullifying a federal tax lien.

By analogy a trustee in bankruptcy obtains no greater rights against debtors of the bankrupt than the bankrupt had. The trustee takes choses in action owned by the bankrupt subject to all defects and defenses which could be asserted by the defendant against the bankrupt. For example, in *Everett v. Judson,* 228 U. S. 474, 57 L. Ed. 927, 33 S. Ct. 568 (1913), the

Supreme Court held that only the cash surrender value of a policy on the life of a bankrupt vests in the trustee under Section 70(a) of the National Bankruptcy Act. This case was cited and relied upon by the Supreme Court in *United States v. Bess, supra,* 357 U. S. 351. This Court in *Goggin v. Bank of America,* 183 F. 2d 323 (9th Cir. 1950), also held that the Bank's right of setoff was in effect and could be asserted as against the bankruptcy trustee, and the trustee's rights were not enlarged by virtue of Sections 60 and 70 of the National Bankruptcy Act. It seems logically to follow that if the trustee's rights can rise no higher than the rights of the bankrupt, the government's rights as a creditor of the taxpayer can rise no higher than the taxpayer's rights.

2. Under Applicable California Law Cross-Demands Are Deemed Compensated so That Under the Facts of the Instant Case There Was No Property or Rights to Property of the Taxpayer in the Possession of the Bank to Which the United States Tax Liens Could Attach.

Section 440 of the California Code of Civil Procedure provides:

> "When cross-demands have existed between persons under such circumstances that, if one had brought an action against the other, a counterclaim could have been set up, the two demands shall be deemed compensated so far as they equal each other, and neither can be deprived of the benefit thereof by the assignment or death of the other."

In other words, under California law cross-demands automatically compensate each other. No action to effect an offset is required of the parties. By operation of law one claim offsets the other.

A complete discussion of the nature of the right of offset is found in *Gonsalves v. Bank of America*, 16 Cal. 2d 169, 105 P. 2d 118 (1940), where the Court said (p. 173):

> "To understand this exercise of the bank's right it is necessary to state briefly its nature. Section 3054 of the Civil Code provides: 'A banker has a general lien, dependent on possession, upon all property in his hands belonging to a customer, for the balance due to him from such customer in the course of the business.' The banker's lien described in this statute is, properly speaking, a lien on the *securities* such as commercial paper deposited with the bank by the customer in the course of business. The so-called 'lien' of the bank on the depositor's *account* or funds on deposit is not technically a lien, for the bank is the owner of the funds and the debtor of the depositor, and the bank cannot have a lien on its own property. The right of the bank to charge the depositor's fund with his matured indebtedness is more correctly termed a right of setoff, based upon general principles of equity. See *Pendleton v. Hellman Commercial T. & S. Bank*, 58 Cal. App. 448 [208 Pac. 702]; 11 Cal. L. Rev. 111, 112; 7 Cal. L. Rev. 341; 38 Harv. L. Rev. 800; Brown on Personal Property, p. 519.
>
> "This right of setoff, however, is not limited in its exercise to the pleading of a counterclaim

in an action. Despite the technical inaccuracy involved in calling it a lien, it is in the nature of a lien or security interest in the funds, similar to and enforceable in the same way as the lien against commercial paper. *That is to say, it is enforceable by the bank's own act, without the aid of a court.* Cases illustrating this exercise of the right of setoff without any action pending are readily found. (See *Pendleton v. Hellman Commercial T. & S. Bank, supra; Mt. Sterling Nat. Bank v. Green,* 99 Ky. 262 [35 S. W. 911, 32 L. R. A. 568]; 38 Harv. L. Rev. 800, 801) . . . And in *Pendleton v. Hellman Commercial T. & S. Bank, supra,* the court said (p. 452): 'But in the case at bar the defense presented is not in the nature of a counterclaim. *Its allegations are, in effect, that there exists no indebtedness of the defendant to the plaintiff.* The bank is not seeking to collect its note from the decedent's estate . . . Appellant's claim here is that by reason of the insolvency of Pendleton, it was entitled to apply the amount of the deposit *pro tanto* to the payment of the note.' " (Emphasis ours).

Simply stated, the Bank's position is, as the Court said in *Pendleton v. Hellman Commercial T. & S. Bank,* 58 Cal. App. 448, that *there existed no indebtedness of the Bank to Edmondson.*

The right of offset exists even though the party exercising the right holds security. *Walters v. Bank of America,* 59 P. 2d 983 (1936) (decision in S. Ct., 9 Cal. 2d 46); *Nelson v. Bank of America,* 76 Cal. App. 2d 501, 173 P. 2d 322 (1946). The Bank's right of offset was completely choate at all times material,

that is, before, at and after the time of the levy, because the right exists by operation of law. In *Crest Finance Co. Inc., v. United States,* 368 U. S. 347, 7 L. Ed. 2d 342, 82 S. Ct. 384 (1961), the Supreme Court held that where accounts receivable had been assigned to a finance company as security for a loan and thereafter a notice of United States tax liens was filed, the finance company had a superior lien. The Supreme Court in that case agreed with the Solicitor General's concession that the lien was completely choate even though, as the government contended before the Seventh Circuit Court of Appeals, the finance company did not have "possession" of the assigned accounts.

The "inchoate concept", as we see it, applies to the situation where the party asserting a lien or security interest must perform some positive act to perfect his lien and the levy is served before the positive act has been performed. In the instant case the Bank did not need to do anything to perfect its right of setoff. All it needed to do was to refuse Edmondson's (or the government's) demand that the Bank discharge the debt. No condition precedent to the existence of the right of setoff needed to be fulfilled. The right of the Bank was therefore fully choate in that Edmondson's debt to the Bank co-existed and exceeded the Bank's debt to Edmondson. It follows that the two debts cancelled on another at all times. The bookkeeping entries made by the Bank were mechanical only and do not affect the substantive rights of the parties.

Analytically, a right or a chose in action is a legally enforceable claim. *People v. Main,* 75 Cal. App. 471, 483, 243 P. 2d 1078 (1925). We must therefore ask the question whether Edmondson at the time of the

levy had a legally enforceable claim against the Bank sufficient to compel the Bank to release to him funds equal to the deposit balance. The answer under the foregoing cases is obviously "no."

If a Court were asked to determine as between Edmondson and the appellant whether the appellant was at the instant before the levy or at the time of the levy obligated to release funds to Edmondson, the judgment under California law would be in the Bank's favor. It follows that Edmondson had no legally enforceable claim and therefore had no "right to property" to which the lien could attach.

3. The Government Had No Enforceable Lien Upon the Checks Deposited by the Taxpayer or Upon the Proceeds Collected by the Bank by the Use of the Checks.

The credit of $6,658.31 (with the exception of the $240 credited to the savings account [Tr. 10]) shown on the books of the Bank in favor of the taxpayer represented credits for negotiable checks endorsed and delivered by the taxpayer to the Bank in July and August, 1959 [Tr. 22-24]. Indeed, $5,478.94 was the balance of credits given by the Bank for checks deposited August 26, 1959, one day before the levy.

In the absence of actual notice of the United States tax liens (and appellant had none [Tr. 19]) the tax liens are invalid as far as the purchaser of a security is concerned. Section 6323(c) of Title 26 of the United States Code provides:

> "Even though notice of a lien provided in Section 6321 has been filed in the manner prescribed in subsection (a) of this section, the lien shall not be valid with respect to a security, as defined in

> paragraph (2) of this subsection, as against any mortgagee, pledgee or purchaser of such security for an adequate and full consideration in money or moneys worth, if at the time of such mortgage, pledge or purchase such mortgagee, pledgee or purchaser is without notice or knowledge of the existence of such lien."

In paragraph 2 of subsection (c) "security" is defined as including any negotiable instrument or money. The Internal Revenue Service by Revenue Ruling 57-367 has recognized that banks could not function if they were compelled, as the District Judge suggested, to search the records of the County Recorder for possible United States tax liens prior to the acceptance of deposits. The Revenue Ruling provides:

> "Assessment: Lien for taxes: Liability of bank: Property of depositor. — Banks, acting in the ordinary course of business with a depositor, without actual notice or knowledge (as distinguished from constructive notice) of a federal tax lien against the property or rights to property of the depositor, and in the absence of negligence or fraud, will not incur liability to the government in making payments of amounts on deposit to or on order of such depositor."

The District Judge was apparently of the opinion that the checks deposited were not subject to any federal lien. Since this is so, neither are the proceeds of the checks the proper subject for a government lien. The checks became the property of the Bank upon deposit, and at the time of the credit a debt arose owing from the Bank to Edmondson which was more than offset by the debts then due from Edmondson to the Bank.

4. The Decision in Bank of Nevada v. United States Is Distinguishable From the Instant Case and Is Inconsistent With Later Supreme Court Decisions.

In the District Court the Government relied heavily upon the decision of this Court in *Bank of Nevada v. United States,* 251 F. 2d 820 (9th Cir. 1957). That case is distinguishable from the instant situation on its facts.

First, as has been demonstrated under California law, cross-demands are deemed to compensate each other. This rule is based upon Section 440 of the California Code of Civil Procedure and *Gonsalves v. Bank of America, supra,* 16 Cal. 2d 169. So far as we have been able to determine, there is no similar statute or case law in the State of Nevada.

Secondly, it is clear that this Court in *Bank of Nevada* based its decision on the proposition that the debt owing by the taxpayer to the Bank was not due at the time of the levy. In this case it is stipulated that all of the conditional sales contract balances, as well as the boat obligation and the unsecured note, were due at the time of the levy. In *Bank of Nevada,* the Court said (p. 826):

> "It is clear that the only fact which gave the appellant the option of set off was the appellee's demand and levy; but that demand and levy admittedly took place prior to the alleged exercise of the appellant's option."

In the instant case the Bank's offset right existed prior to, at the time of and after the levy and no option is involved.

In *Bank of Nevada* the Court said (p. 824):

> "The Supreme Court has repeatedly and emphatically stated that federal tax liens and the provisions for collection are strictly *federal* and strictly *statutory*. Its provisions are unaffected by any alleged 'general rule' that a bank has a 'general lien' upon deposits."

We respectfully submit that the foregoing premise is not in accord with the expressions of the Supreme Court found in *United States v. Bess, supra,* 357 U. S. 51, and *Aquilino v. United States, supra,* 361 U. S. 501, discussed in Section 1 of the argument in this brief. We submit that we are here involved first with the application of state law to determine the extent of the Bank's obligation to the taxpayer. It is only after a decision can be reached that the taxpayer had a legally enforceable claim against the Bank that we reach any federal question.

We further submit that the decision in *Bank of Nevada* is inconsistent in principle with *Aquilino* and *Bess* decided by the Supreme Court subsequently and that it is also at variance with *In re Halprin, supra,* 280 F. 2d 407, and the other cases discussed in Section 1 of this Argument. As we read those cases the fundamental approach is whether or not the taxpayer could force his debtor to pay the money over to him at the time of the levy, and where the Court finds that the taxpayer could not compel such a payment there is nothing to which the government's lien can attach. This ruling is based upon the concept that the government's

rights against the debtor of the taxpayer can rise no higher than the taxpayer's rights. In the instant case, the Bank's refusal to pay Edmondson could take place any time prior to actual payment by the Bank. To illustrate, if Edmondson had walked to the window of the Bank at the same instant that the Government Revenue Agent presented the notice of levy, the Bank could have refused to honor Edmondson's demand and also simultaneously refused to honor the government's levy unless the government's rights rose higher than those of Edmondson, and the Supreme Court has said that they do not. *United States v. Bess, supra.*

In *Bank of Nevada v. United States* the Court relied in part upon the District Court decision in *United State v. Graham,* 96 Fed. Supp. 318-321, affirmed *per curiam sub nom., State of California v. United States,* 195 F. 2d 530 (9th Cir. 1952). We believe that this case also is inconsistent with the opinions of the Supreme Court in *United States v. Bess* and *Aquilino* and cases in other circuits cited in Section 1 of this brief. It is further to be noted that the reasoning of the District Court in *Graham* is not applicable to the instant situation because of the special exception with respect to negotiable instruments and bank deposits found in Title 26 United States Code, Section 6323, as implemented by Revenue Ruling 57-367, I. R. B. 1957 32, 22, quoted in the preceding section of this brief.

Conclusion.

State law controls the decision as to the existence of rights to property subject to a federal tax lien. Under California law the taxpayer had no right, legally enforceable, to compel the payment of the Bank's obligation to him because of the offsetting debt owed by him to the Bank. The District Court was clearly wrong in granting the government's motion for summary judgment and in refusing to grant the Bank's motion.

Respectfully submitted,

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Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Robert H. Fabian